



MCI Telecommunications  
Corporation  
1133 19th Street, NW  
Washington, DC 20036  
202 872 1600

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

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April 5, 1991

Ms. Donna Searcy  
Secretary  
Federal Communications Commission  
Room 222  
1919 M Street, N.W.  
Washington, D.C. 20554

Re: **The Allowance for Funds Used During Construction (AFUDC)  
Rate Properly Charged By Dominant Carriers For Ratemaking  
and Other Purposes (RM-7626).**

Dear Ms. Searcy,

Enclosed herewith for filing are the original and nine (9) copies of MCI Telecommunications Corporation's Reply Comments to the above-captioned proceeding.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Petition furnished for such purpose and remit same to the bearer.

Yours truly,

Carol Schultz, Esq.  
Federal Regulatory Policy

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BEFORE THE  
FEDERAL COMMUNICATIONS COMMISSION  
WASHINGTON, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of:

The Allowance for Funds Used	)	
During Construction Rate Properly	)	
Charged by Dominant Carriers For	)	RM-7626
Ratemaking and Other Purposes	)	

REPLY COMMENTS

MCI Telecommunications Corporation ("MCI") respectfully submits reply comments in the above-captioned proceeding. Four parties filed in favor of Ameritech's petition.<sup>1</sup> To the extent that these filings purport to support the rule proposed by Ameritech, they advance similar shopworn and erroneous arguments. In addition, each of the other parties used the comment cycle as a platform for requesting that the Commission institute a rulemaking to reconsider its chosen method of regulating interest during construction (IDC) for ratemaking purposes. The methods proposed by these parties have already been considered and rejected by the Commission in a decision upheld by the courts. In any case, such proposals would thwart the Commission's policies, which are embodied in the existing rules, to distinguish between current and future ratepayers, and appropriately compensate investors. No participant has advanced any credible reason for the Commission to use its finite resources to consider methods that it has found deficient in past proceedings. Thus, MCI respectfully requests the Commission to deny Ameritech's petition.

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<sup>1</sup> The comments that MCI will address in its reply were filed by BellSouth Corporation, South Central Bell Telephone Company and Southern Bell Telephone Company (BellSouth), New York Telephone Company and New England Telephone and Telegraph Company (NYNEX), Southwestern Bell Telephone Company (SWBT), and the United States Telephone Association (USTA).

I. NO SUFFICIENT ARGUMENT HAS BEEN RAISED TO CHANGE THE COMMISSION'S DETERMINATION OF REASONABLE INTEREST ON LONG-TERM CONSTRUCTION

BellSouth, USTA and Southwestern Bell erroneously assert, as did Ameritech, that the Commission should consider the actual funding used by telephone companies in determining the appropriate interest rate for AFUDC.<sup>2</sup> The assumption that the Commission adopted the prime rate based upon AT&T's actual funding of construction projects is simply in error. In choosing the prime rate, the Commission did not base its decision upon, nor was it required to consider, the actual funding used by AT&T.<sup>3</sup> In fact, the Commission specifically stated that AT&T did not use short-term debt to fund all of its construction.<sup>4</sup> The Commission was confident, however, that AT&T could increase its use of short-term funding, and that this practice, coupled with proper management of construction projects to assure their timely placement in service, would benefit both the ratepayer and the investor.<sup>5</sup> None of the parties has asserted that it cannot fund construction in this manner.

BellSouth also alleges that the Commission's original decision was "illogical" because the Commission did not adjust for short term debt used for long-term construction in setting the overall cost of capital.<sup>6</sup> In making its assertion, BellSouth ignores the Commission's finding that short-term debt was such a minute portion of

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<sup>2</sup> BellSouth, pp. 2-3, SWBT, pp. 1-2, and USTA at p. 2.

<sup>3</sup> See, MCI Opposition, pp. 5-7, for a full discussion of the Commission's decision on the use of prime rate.

<sup>4</sup> AT&T - Charges for Interstate Services, 64 F.C.C.2d 1 (1977), recon., 67 F.C.C.2d 1429 (1978), pp. 59-60. (Docket 19129).

<sup>5</sup> See, MCI Opposition, pp. 5-7.

<sup>6</sup> BellSouth pp. 2-3.

the overall capital structure, but such a large portion of the overall construction budget (including PUC-ST) that it could be increased to cover a larger portion of PUC without changing the overall cost of capital.<sup>7</sup> Thus, contrary to BellSouth's implication, the Commission specifically considered the issue and found that, due to the *de minimis* impact on the overall cost of capital, the adjustment that BellSouth recommends was simply unnecessary.

Finally, both SWBT and BellSouth erroneously join with Ameritech in alleging that the existing rules discourage investment in the infrastructure.<sup>8</sup> However, as MCI discussed in its Opposition, changing the rules so that PUC-LT is compensated as if it is currently used and useful does not incent LECs to increase investment in the infrastructure, and may actually promote delay of construction projects, to the detriment of an improved infrastructure.<sup>9</sup>

In summary, none of the filed comments has raised issues or identified changes since the Commission's prior decision that would justify modifying the existing practice of using the prime rate for accruing IDC. MCI therefore respectfully requests that the Commission deny Ameritech's Petition for Rulemaking.

## II. SUFFICIENT REASON HAS NOT BEEN DEMONSTRATED TO RELITIGATE THE COMMISSION'S DECISION TO EXCLUDE PUC-LT FROM THE RATEBASE

Prior to 1978, the Commission's rules treated plant under construction the same regardless of the length of time that a project would take to complete, due to the fact

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<sup>7</sup> Docket 19129 at p. 60.

<sup>8</sup> BellSouth at p. 3, SWBT at p. 3.

<sup>9</sup> See, MCI Opposition at p. 8.

that most of AT&T's projects had previously been of short duration.<sup>10</sup> However, in Docket 19129, the Commission considered several Staff criticisms of its then existing methodology, and established that projects to be completed in over one year, i.e. plant under construction - long-term (PUC-LT), must be treated differently from plant under construction - short-term (PUC-ST).<sup>11</sup> PUC-ST was to be included in the ratebase because it was difficult to separate the benefits of PUC-ST between current and future ratepayers.<sup>12</sup> However, the projects defined as PUC-LT were found not "presently used and useful for communications services,"<sup>13</sup> and thus the Commission found that for such "large costly, longer-term projects"<sup>14</sup> it is "both feasible and necessary to distinguish between current and future ratepayers."<sup>15</sup> Therefore,

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<sup>10</sup> Docket 19129 pp. 56-57.

<sup>11</sup> The Commission considered three possible methods of compensation for PUC:

1.Exclude plant under construction from the rate base but capitalize interest on such plant. The interest capitalized during construction is included in the cost of utility plant when the construction work is placed in service. The interest during construction that is credited to income is excluded from income for ratemaking purposes. [Method 1]

2.Include plant under construction in the rate base and charge interest during construction. The interest during construction is included in income for ratemaking purposes and is added to the construction work in progress to be included in utility plant when the construction work is placed in service. [Method 2]

3.Include construction work in progress in the rate base and do not capitalize interest during construction. [Method 3]

The Commission adopted Method 3 for PUC-ST, and Method 1 for PUC-LT, whereas Method 2 had previously been used for all PUC, regardless of the length of time to complete a project. See, Id. pp. 56-60.

<sup>12</sup> Id. at p. 59.

<sup>13</sup> Id. at p. 60.

<sup>14</sup> Id. at p. 59.

<sup>15</sup> Id.

PUC-LT could not be included in the ratebase, but to appropriately compensate investors, IDC was allowed to be accrued at the compounded prime interest rate.<sup>16</sup>

The Commission concluded:

In summary, we find sufficient merit in the Trial Staff's criticisms of our present procedures for treating PUC and IDC to institute changes to eliminate some of the problems it has asserted. In particular, the desirability and feasibility of separating future ratepayers from current ones in bearing the costs of longer-term projects has led us to adopt the two-step procedures indicated above.<sup>17</sup>

Thus, the Staff objections that entered into the Commission's decision related to the treatment of current and future ratepayers. Specifically, the Staff was concerned that when projects were abandoned, there was "no practical way, under the present accounting method, to make current ratepayers whole,"<sup>18</sup> and when projects were suspended, including PUC in the ratebase unfairly burdened current ratepayers and was thus inconsistent with the Commission's regulations.<sup>19</sup> Although the Staff disparaged other aspects of the then existing IDC rules, such criticisms were not considered by the Commission in making its determination.<sup>20</sup>

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<sup>16</sup> Id. at p. 59.

<sup>17</sup> Docket 19129 at p. 60.

<sup>18</sup> Id. at p. 57.

<sup>19</sup> Id. at p. 57.

<sup>20</sup> The Commission also noted that problems could arise with respect to turnkey projects, but found the issue moot since AT&T had no such projects. Id., pp. 57-58. Similarly, the Commission noted problems with the accounting treatment of Western Electric tax credits. AT&T was reluctant to appropriately adjust IDC for Western Electric tax credits, claiming that calculating IDC was so imprecise that any failure to adjust IDC for tax credits would have a *de minimis* impact. The Commission refused to accept imprecision in IDC calculation as justification for failure to adjust IDC for the tax credits, and found that, in any case, the new method of IDC calculation eliminated such imprecision. Thus, problems in accounting for Western Electric tax credits were not used as a rationale for changing the method of IDC. Rather, changing the method of IDC was only one reason to deny AT&T's attempt to avoid the appropriate treatment of such credits. Id.

The Commission subsequently extended its policy of excluding PUC-LT from the ratebase to the LECs and the court denied Ameritech's challenge of that decision, finding that the Commission had acted reasonably in adopting its existing rules.<sup>21</sup>

The other parties filing comments in this proceeding ignore the Commission's policy statements and propose that the Commission readopt the method of including PUC-LT in the ratebase.<sup>22</sup> Essentially, they advocate relitigating the Commission's previous decision but, as demonstrated below, they do not advance any factual or legal basis to consider a change to the Commission's existing rules.

SWBT erroneously alleges that the ratepayer derives a direct benefit from PUC-LT including "the ability of the related asset to be used within a reasonable time" and that, therefore, PUC-LT "clearly meets the 'used and useful' standard."<sup>23</sup> SWBT's assertions are not based on any new facts, and directly contradict the Commission's previous policy holding:

We have also found that the difference between used and useful plant in service and longer-term plant under construction warrants separate treatment by this Commission for ratemaking purposes.<sup>24</sup>

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<sup>21</sup> See, Illinois Bell Telephone v. F.C.C. 911 F.2d 776 (D.C. Cir 1990) (Illinois Bell) at p. 781.

<sup>22</sup> The three methods of compensating for PUC are delineated in Footnote 15, above. NYNEX proposes that the Commission adopt Method 2 for PUC-LT (NYNEX pp. 5-6). Southwestern Bell recommends that the Commission adopt Method 3, (SWBT pp. 2-3) and BellSouth urges the Commission to consider Method 2 and Method 3, in addition to Ameritech's proposal of excluding PUC-LT from the ratebase, but accruing AFUDC at the prescribed rate of return (BellSouth pp. 3-4). USTA asks that the Commission consider "alternative means which will ensure that carriers can recover the full costs of construction." (USTA at p. 2.)

<sup>23</sup> SWBT at p. 3.

<sup>24</sup> Docket 19129 at p. 60.

SWBT also asserts that the Commission's one year cut-off is an arbitrary distinction as many projects are completed in shortly over a year.<sup>25</sup> However, the courts have already determined that the Commission was acting within its discretion in selecting the one-year criterion.<sup>26</sup> In any case, the carrier alone has the ability to manage its projects such that they will be completed within the Commission's chosen parameters. That SWBT's failure to do so should be considered in determining the appropriate timeframe is simply ridiculous.

Finally, SWBT reiterates Ameritech's assertion that the exclusion of PUC-LT and capitalizing AFUDC result in higher rates. Since multiple parameters affect whether or not rates would be higher over time, Ameritech's self-serving analysis proves little.<sup>27</sup> In any event, the court has already upheld the Commission's decision to distinguish between the impacts on current and future ratepayers, even if that policy should result in higher rates.<sup>28</sup> Thus, SWBT's attempt to relitigate the Commission's decision provides no support for a rulemaking on this issue.

BellSouth makes an unsubstantiated assertion that facts have changed since the Commission decided upon the method of compensating for IDC on PUC-LT.<sup>29</sup>

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<sup>25</sup> SWBT at p. 3.

<sup>26</sup> The court noted in the Illinois Bell decision that "The Commission has considerable discretion to determine the appropriate time, in advance of property going into service, at which it first becomes 'necessary to the efficient conduct of a utility's business'; it may distinguish among various types of expenditures upon the basis of any relevant concern, including its concern with the differing incentives it has invoked in the cases of PUC-LT and PHFU." Illinois Bell at p. 782.

<sup>27</sup> See, MCI Opposition at fn. 10.

<sup>28</sup> "The Commission's approach is not irrational simply because deferring recovery of the cost of capital means that, over the life of the plant, ratepayers will pay more—a very slight percentage more, it appears than they would if the plant were taken immediately into the rate base (but, as suggested, not depreciated). This effect is inherent in any effort to shift the burden of a present investment to those who will benefit from it in the future...." Illinois Bell at p. 782.

<sup>29</sup> BellSouth pp. 1-2.



BellSouth erroneously claims that the Commission's decision in Docket 19129 was based in part upon the issue of ratebase treatment for Western Electric tax credits. As discussed above, the Commission decided to exclude PUC-LT from the ratebase because of the inequities that would otherwise result to current ratepayers<sup>30</sup>.

Although problems in implementing Western Electric tax credits were reviewed during the Commission's consideration for the change in methodology for IDC, it is clear from the Commission's discussion that such problems did not enter into the Commission's decision on a method of compensating for IDC on PUC-LT<sup>31</sup>. Thus, whether or not such tax credits exist today is irrelevant to the question of whether a rulemaking is necessary.

Finally, NYNEX asserts that the Commission should change its rules because the ratemaking rules do not match what GAAP or the Commission's accounting rules require.<sup>32</sup> However, accounting and ratemaking are designed to accomplish different purposes. Accounting rules are designed to capture an entity's actual financial situation. Ratemaking is a process whereby investor and ratepayer interests are balanced so that investors may receive an equitable return, and ratepayers pay a reasonable rate. There is no reason that the methods for one be applied to the other. The Commission thus has used its discretion to determine a capital structure,<sup>33</sup> as well as the AFUDC rate and other financial parameters that do not necessarily correspond to the actual practices of a regulated entity. In fact, the Commission has

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<sup>30</sup> Docket 19129 pp. 57-58.

<sup>31</sup> Docket 19129 at p. 58.

<sup>32</sup> NYNEX pp. 2-6.

<sup>33</sup> The Commission expressly stated in the original *Comcast* decision that it had the prerogative to impute a reasonable capital structure. 56 FCC 2d 1160 (1975).

specifically declined to make the two consistent as they relate to AFUDC.<sup>34</sup> Nothing has occurred since that decision was made that would support holding a rulemaking to change the Commission's prior decision.

### III. CONCLUSION

The lack of relevant supporting comments to Ameritech's petition attests to the simple fact that the Commission's decision to exclude PUC-LT from the rate base and to require IDC to be compounded at the prime rate is a fair and equitable solution, enuring to the benefit of the ratepayer as well as the investor. Thus, MCI respectfully requests that the Commission keep its existing rules and deny Ameritech's petition.

Respectfully submitted,

MCI TELECOMMUNICATIONS CORPORATION



Carol Schultz, Esq.  
Its Attorney  
1133 19th Street NW  
Washington DC 20036  
(202) 887 - 3101

Dated: April 5, 1991

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<sup>34</sup> See, Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, Order on Reconsideration, 4 F.C.C. Rcd. No. 4 1697 (1989), at p. 1703.

**CERTIFICATE OF SERVICE**

I, Marilyn Brundage, do hereby certify that copies of the forgoing MCI Petition were sent via first class mail, postage paid, to the following on this 5th Day of April 1991:

Richard Firestone\*\*\*  
Chief, Common Carrier Bureau  
FCC Room 500  
1919 M Street, N.W.  
Washington, D.C. 20554

John Cimko, Jr.\*\*\*  
Chief, Tariff Division  
FCC Room 544  
1919 M Street, N.W.  
Washington, D.C. 20554

Ken Moran\*\*\*  
Accounting and Audits Division  
Room 812  
2000 L Street, N.W.  
Washington, D.C. 20554

Downtown Copy Center\*\*\*  
Room 246  
1919 M Street, N.W.  
Washington, D.C. 20554

John C. Litchfield  
Assistant Vice President  
Ameritech  
10 S. Wacker Drive, Floor 22  
Chicago, IL 60606

Cliff Rand\*\*\*  
Accounting and Audits Division  
Room 812  
2000 L Street, N.W.  
Washington, D.C. 20554

Linda Kent  
Associate General Counsel  
United States Telephone Association  
900 19th Street, N.W.  
Suite 800  
Washington, D.C. 20006-2105

M. Robert Sutherland, Esq.  
BellSouth Corporation  
1155 Peachtree Street, N.E.  
Suite 1800  
Atlanta, Georgia 30367

Diane J. Harter, Esq.  
Southwestern Bell Telephone Company  
1010 Pine Street, Room 2114  
St. Louis, Missouri 63101

Campbell L. Ayling, Esq.  
The NYNEX Telephone Companies  
120 Bloomingdale Road  
White Plains, NY 10605

\*\*\*HAND DELIVERED

  
Marilyn Brundage